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COMMENT

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW.
Washington, DC 20581
Fax 202-418-5521
Email secretary@cftc.gov

Re: Revision of Federal Speculative Position Limits

Our company – Advance Trading, Inc., Bloomington, Illinois - is involved in the trading of grain in the U.S. Over the last 2.5 years we have experienced an abrupt decrease in the "convergence" of cash grain prices with the futures-market prices in Chicago, Kansas City, and Minneapolis. In each of the seven agricultural and processed commodities traded on those exchanges, cash prices have increasingly failed to "converge," i.e., to reach an exact equivalence with futures, as is the primary function of futures markets, during each successive period when contracts expire.

Agriculture is unique in that the entire year's supply is "manufactured" in one lump, at harvest time, creating a natural warehousing function in the industry: A huge quantity must be stored at harvest, to be allocated out as needed through the following summer. That is why there are forward futures contracts: To reflect a different future price relative to the spot contract, accurately representing carrying charges (i.e., warehousing profits) which signal the warehouseman (grain elevators) whether the market needs him to ship or store grain. Accurately reflecting cash-market carrying charges is the sole reason why futures markets were created, to avoid the boom-and-bust of each year's transition from an initial oversupply to final scarcity by transparently rationalizing the always-changing supply-and-demand reality of the moment.

The mechanism, which keeps "paper" futures connected to cash prices, is convergence of the two, to the same price, during each successive futures contract's expiration. As a result, all participants are supposed to be able to view the nearby futures contract and know that its price will be precisely that of a well-defined grade of cash grain at the delivery point during that month. When that does not happen - or, worse, the current situation in which it structurally *cannot* happen - the futures markets revert back toward the boom-and-bust agricultural chaos that it was invented to solve. The less that futures serve as an accurate proxy for cash, the greater the risk for elevators and others involved in the grain business, having as one effect that elevators are forced to lower their bids to farmers to force wider margins for themselves – they have no choice.

The current situation is severe enough, for structural reasons, that volatility is being forced into the cash markets, which the futures are unable to reflect. Specifically, basis levels are much lower than they would be if futures markets were functioning normally, which they cannot due to inflexibility in the current rules.

In a normal market, if basis levels were out-of-sync-low to futures, a hedger could rely on relationships between futures widening to signal elevators to hold grain back – providing an incentive to reduce their shipping volume - which makes cash-basis levels climb back to the intended closer relationship with futures. That is how the futures-market mechanism keeps cash grain and "paper" futures properly related. Regardless of what grain prices are, whether government biofuels subsidy sharply boosts price or huge hedge-fund speculation adds volatility, this cash-vs-futures connection must continue to function or the "real" grain business, and the futures prices themselves, are at risk of dysfunction.

If additional futures-buying is introduced by increased speculative position limits while spreads are prevented from widening further to account for greater borrowing costs, etc. - because they're already up against the artificial maximums in current rules - the divergence between cash and nearby futures ("cash basis') will be forced even lower. This doesn't just create loss and uncertainty for grain elevators, but also for farmers, industrial and livestock users, and everyone even peripherally involved.

The National Grain and Feed Association's Country Elevator Committee made the following three comments:

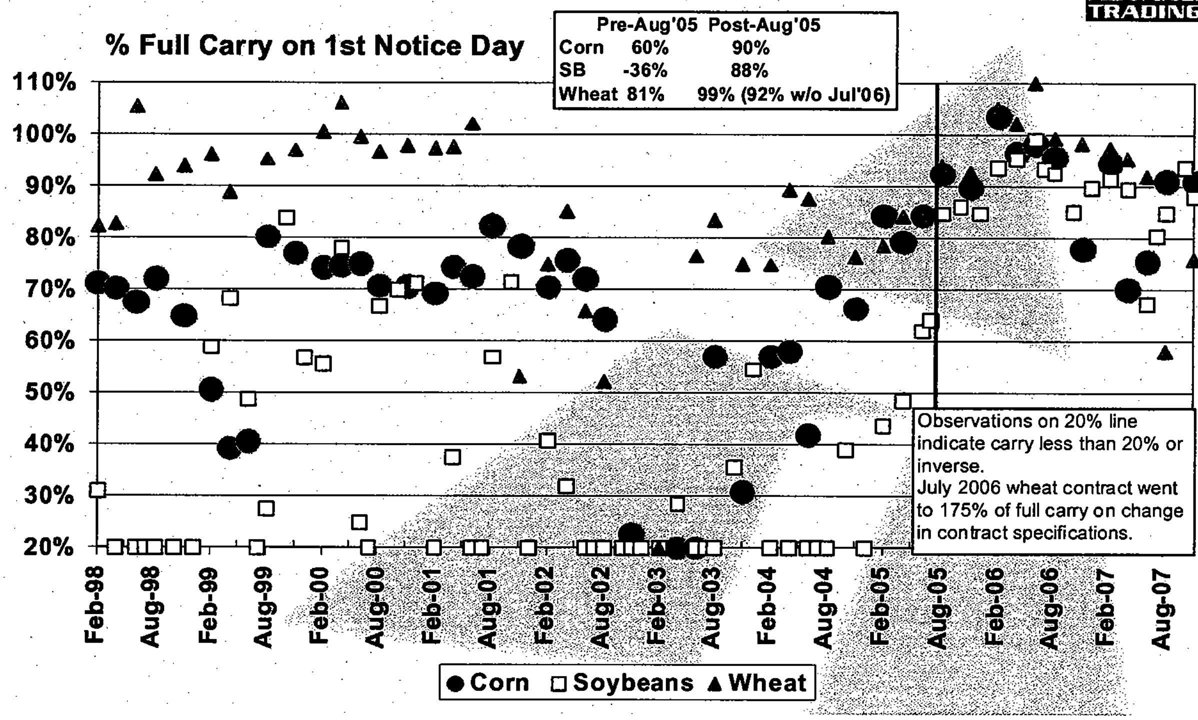
1. Increased volatility is being forced into the cash market, where country elevators continue to lose origination of farmer grain to long hedgers and organizations with large basis trading networks that can accomplish in cash that which cannot be accomplished in futures. In this environment, country elevators are unable to merchandise competitively without the confidence that convergence will occur. As such, the country elevator' s role as the first hedger of price risk in the market is in peril. Removing the country elevator from the merchandising chain potentially removes its vital function of price discovery from the marketplace.

2. Increased volatility in the cash market has decreased the agricultural producer's ability to utilize futures for price discovery and risk transfer.

3. Actions by traditional short hedgers to avoid the real or perceived risk due to the lack of consistent convergence are reducing utilization of futures. This is occurring at a time when the CFTC's proposals would increase the demand for liquidity to balance the demand by the index and hedge funds.

The current market is unbalanced. A graphic expression of this is shown below.

% Full Carry on 1st Notice Day



This chart depicts the percentage of "full carry" – the arbitrary maximum specified in each futures contract's design – on "first notice day" for the last ten years in each of the three major grain-futures contracts at the Chicago Board of Trade. In all of them, the futures "carry" changed distinctly beginning in August 2005, to a far wider relationship, which has predominantly verged on the maximum allowed under the CBOT rules. Corn averaged around 60% prior to Aug 2005, but 90% since. Soybeans averaged a negative 36% before, positive 88% after. Wheat has other contract problems pertaining to grade, which had kept it at an extraordinarily wide 81% before, but it also widened further, to 92%, after.

What does it mean when the futures spreads in all three, through situations of relative oversupply and scarcity which are supposed to widen and narrow them to regulate those situations, are almost unchangingly at the limit allowed under CBT rules? *It says that that limit is restricting movement in the futures market so that it cannot reflect changes in, nor converge with, the cash grain market.* So over the last 2.5 years, the basis has been forced to do the work that, due to contract design, the futures market cannot. Thus, especially with ever-larger speculative limits, the futures market price is, by definition, not very accurate relative to cash price a high percentage of the time.

Without futures-exchange rules which allow sufficient flexibility for successful convergence under all price conditions, the resultant cash-futures divergence which the rules are aimed at preventing places the natural hedged short (the farmer and the country elevator) under so much pressure that he can be forced to withdraw from the futures market – a throwback to pre-futures-exchange days. That has already begun to happen. Essentially, while futures prices soar, the short futures hedger loses because his cash grain ownership becomes worth less relative to his hedge. Conversely, the long hedger profits by the artificial premium that the current rules confer on futures relative to the lower cash, when of course the two are supposed to be the same.

The volatility of short hedgers' cash grain position is increased, while the volatility of long hedgers' position is reduced. Lack of convergence due to inflexible contract rules means that *by design* the longs are advantaged relative to the shorts.

"Convergence" is the primary regulator of futures markets, which are of course free markets open to all. But how can CFTC enact position-limit expansion for speculators when that will exacerbate an already-severe, quantifiable problem with the grain futures contracts' basic functioning? Futures prices are already outrunning the delivery rules' ability to link them to actual cash grain prices.

For these reasons, we think adding more speculative interest to a futures market that already is demonstrably unable to converge, therefore not functioning well, is imprudent. Until the exchanges adequately address the lack of convergence with changes in contract design, we oppose increasing speculative limits.

Respectfully,

Jeffrey W. Hainline